

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:NER:PEN:PHI:TL-N-3096-99  
JCFee

date: May 14, 1999

to: Chief, Examination Division, Pennsylvania District  
Attn: Chief, Planning and Special Programs  
Attn: Craig Kessler E:PSP:DC

from: Assistant District Counsel, Pennsylvania District, Philadelphia

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subject: Examination of Books and Records Under Section 7605(b)

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

You have requested our advice on the following issue involving restrictions on examinations of returns and inspections of books and records:

Issue

Whether compliance checks which involve requesting taxpayers to verify their basis in S Corporation stock constitute examinations of shareholders' return and inspections of books and records under §7605(b).

### Conclusion

Your inquiries to the taxpayers constitute examinations of the shareholders' return and inspections of books and records under §7605(b). As such, the Service must provide notice to the taxpayer before performing any further inspections and examinations of the shareholders' return. The inquiries regarding basis do not constitute an examination of the S Corporation return or an inspection of the corporate books and records.

### Analysis

As we understand the facts, the Examination Division is performing compliance checks under §1366(d) to determine if taxpayers are deducting S Corporation losses in excess of their bases in stock and debt. We assume that the Examination Division's determination cannot be made by the mere inspection of the S Corporation information return or the shareholders' income tax returns. Accordingly, we also assume that you must contact the taxpayers in order to make the basis determination.

Section 7605(b) provides the following restrictions on the examination of taxpayers:

No taxpayer shall be subjected to unnecessary examination or investigations, and **only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.**

If the first "inspection" consists only of an examination of taxpayer's Form 1040 or the related S Corporation information return the Service would be free to perform a subsequent examination without regard to the limitations of §7605(b). The law is settled that a "review of the [tax return], and accompanying schedules, does not constitute an inspection of a taxpayer's 'books of account.'" Benjamin v. Commissioner, 66 T.C. 1084, 1097 (1976), affd. 592 F.2d 1259 (5th Cir. 1979); Geurkink v. United States, 354 F.2d 629 (7th Cir. 1965).

In Benjamin, the taxpayer argued that by merely questioning a taxpayer about matters contained in his books of account, the revenue agent had performed an inspection for purposes of §7605(b). The taxpayer argued that any "meaningful exchange" between revenue agent and a taxpayer about these matters is an

examination of the taxpayer's records. The Tax Court disagreed finding that since the revenue agent never had possession of nor inspected petitioners' books of account, there could be no second inspection under §7605(b). Inspecting the "books of account" requires, at a minimum, that the revenue agent have access to and physically view a taxpayer's books and records. The Court held that, since one agent having access to the books did not actually view the taxpayer's books, and another agent had neither access to nor physical control of petitioners' business records, no inspection had occurred for purposes of §7605(b).

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With respect to the S Corporation, inspection of shareholders' books and record do not constitute an inspection of the corporate records for purposes of §7605(b). The corporation and a shareholder are viewed as two separate legal persons and two separate and distinct taxpayers. See, e.g. Guerkink v. United States, 354 F.2d 629 (7th Cir. 1965) holding that the inspection of the corporation's books does not constitute an inspection of the shareholder's books.

This concludes our advice and recommendation. Please feel free to call Attorney James C. Fee, Jr. at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) (CC:NER) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS:PROC) for mandatory 10 day post review. To assure that the National Office has had sufficient time to review our advice, we request that you refrain from taking any action with respect to the taxpayer's claim prior to May 28, 1999.

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JOSEPH M. ABELE

cc: Assistant Regional Counsel (Tax Litigation) (CC:NER)  
Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS:  
PROC)

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